DEPARTMENT OF STATE REVENUE

04-20181374R.ODR

Final Order Denying Refund: 04-20181374R
Sales Tax
For The 2014 Tax Year

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this document.

HOLDING

Business was not entitled to refund because it failed to substantiate its claimed bad debt deduction under Indiana law.

ISSUE

I. Sales Tax - Refund of Sales Tax - Bad Debt Deduction.

Authority: I.R.C. § 166; IC § 6-2.5-6-9; IC § 6-8.1-9-1; *Dept. of State Revenue v. Caterpillar, Inc*., 15 N.E.3d 579 (Ind. 2014); *SAC Finance, Inc. v. Indiana Dept. of State Revenue*, 24 N.E.3d 541 (Ind. Tax Ct. 2014); Final Order Denying Refund 04-20160448R (August 2017).

Taxpayer protests the denial of its refund claim for 2014.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation in the auto finance business. In December of 2017, Taxpayer filed a GA-110L Form, claiming that it was entitled to an approximately $31,000 refund of "sales tax that was erroneously paid on automobiles that were subsequently repossessed."

The Indiana Department of Revenue ("Department") repeatedly contacted Taxpayer requesting that Taxpayer substantiate its refund claim. Taxpayer was not able to provide verifiable source documents to support its refund claim. Eventually, the Department denied Taxpayer's refund claim. The Department explained in the March 14, 2018, letter, in part:

> Denied in full per IC [§] 6-8.1-9-1[.] Requested information and documentation was not provided thus the Department cannot determined the correctness of the claim.

Taxpayer protested the refund denial. An administrative phone hearing was held. This Final Order Denying Refund results. Further facts will be provided as necessary.

I. Sales Tax - Refund of Sales Tax - Bad Debt Deduction.

DISCUSSION

The Department reviewed Taxpayer's refund claim and determined that Taxpayer was not entitled to the refund because it failed to substantiate its claim.

Taxpayer claimed that it was entitled to a refund of approximately $31,000 "sales tax that was erroneously paid on automobiles were subsequently repossessed." The refund at issue in this instance stemmed from consumer car loans that Taxpayer claimed it acquired from its affiliate (a car dealership) which included sales tax on sales of automobiles. Taxpayer claimed that it was entitled to the refund of sales tax because it was "permitted to deduct from sales tax the amount of its receivables that were written off as uncollectible debt less the excluded figure." In other words, Taxpayer believed that it was entitled to receive a refund of sales tax which was included in those consumer loans which it purchased from a related entity and a portion of which Taxpayer listed as repossession losses on its federal income tax return.

Accordingly, the issue is whether Taxpayer is entitled to a refund of sales tax (on sales of automobiles) which was included in the car loans that were subsequently acquired by Taxpayer from its affiliate.

IC § 6-8.1-9-1(a) affords a taxpayer a statutory right to file a claim for refund if the taxpayer determines that the taxpayer has paid more tax than the amount is legally due for a particular taxable period. To obtain the refund, the taxpayer is required to file the claim with the Department within three (3) years from the date of payment if that date is later than the due date of the return. "The claim must set forth the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund." *Id.* In this instance, Taxpayer timely filed the refund claim.

In addition, "when [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc*., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision shall be entitled to deference.

The Indiana sales tax bad debt deduction is found under IC § 6-2.5-6-9 (applicable during the tax year 2014), which provides in relevant part:

> (a) In determining the amount of state gross retail and use taxes which a retail merchant must remit under section 7 of this chapter, the retail merchant shall, subject to subsections (c) and (d), deduct from the retail merchant's gross retail income from retail transactions made during a particular reporting period, an amount equal to the retail merchant's receivables which:
> (1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser;
> (2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and
> (3) were written off as an uncollectible debt for federal tax purposes under Section 166 of the Internal Revenue Code during the particular reporting period.
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> (b) If a retail merchant deducts a receivable under subsection (a) and subsequently collects all or part of that receivable, then the retail merchant shall, subject to subsection (d)(6), include the amount collected as part of the retail merchant's gross retail income from retail transactions for the particular reporting period in which the retail merchant makes the collection.
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> (c) This subsection applies only to retail transactions occurring after June 30, 2007. As used in this subsection, "affiliated group" means any combination of the following:
> (1) An affiliated group within the meaning provided in Section 1504 of the Internal Revenue Code (except that the ownership percentage in Section 1504(a)(2) of the Internal Revenue Code shall be determined using fifty percent (50[percent]) instead of eighty percent (80[percent])).
> (2) Two (2) or more partnerships (as defined in IC 6-3-1-19), including limited liability companies and limited liability partnerships, that have the same degree of mutual ownership as an affiliated group described in subdivision (1), as determined under the rules adopted by the department. The right to a deduction under this section is not assignable to an individual or entity that is not part of the same affiliated group as the assignor.
>
> (d) The following provisions apply to a deduction for a receivable treated as uncollectible debt under subsection (a):
> (1) The deduction does not include interest.
> (2) The amount of the deduction shall be determined in the manner provided by Section 166 of the Internal Revenue Code for bad debts but shall be adjusted to exclude:
> (A) financing charges or interest;
> (B) sales or use taxes charged on the purchase price;
> (C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;
> (D) expenses incurred in attempting to collect any debt; and
> (E) repossessed property.
> (3) The deduction shall be claimed on the return for the period during which the receivable is written off as uncollectible in the claimant's books and records and is eligible to be deducted for federal income tax purposes. For purposes of this subdivision, a claimant who is not required to file federal income tax returns may deduct an uncollectible receivable on a return filed for the period in which the receivable is written off as uncollectible in the claimant's books and records and would be eligible for a bad debt deduction for federal income tax purposes if the claimant were required to file a federal income tax return.
> (4) If the amount of uncollectible receivables claimed as a deduction by a retail merchant for a particular

reporting period exceeds the amount of the retail merchant's taxable sales for that reporting period, the retail merchant may file a refund claim under IC 6-8.1-9. However, the deadline for the refund claim shall be measured from the due date of the return for the reporting period on which the deduction for the uncollectible receivables could first be claimed.
(5) If a retail merchant's filing responsibilities have been assumed by a certified service provider (as defined in IC 6-2.5-11-2), the certified service provider may claim, on behalf of the retail merchant, any deduction or refund for uncollectible receivables provided by this section. The certified service provider must credit or refund the full amount of any deduction or refund received to the retail merchant.
(6) For purposes of reporting a payment received on a previously claimed uncollectible receivable, any payments made on a debt or account shall be applied first proportionally to the taxable price of the property and the state gross retail tax or use tax thereon, and secondly to interest, service charges, and any other charges.
(7) A retail merchant claiming a deduction for an uncollectible receivable may allocate that receivable among the states that are members of the streamlined sales and use tax agreement if the books and records of the retail merchant support that allocation.

I.R.C. § 166 further states:

(a) General rule. -
(1) Wholly worthless debts. - There shall be allowed as a deduction any debt which becomes worthless within the taxable year.
(2) Partially worthless debts. - When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(b) Amount of deduction - For purposes of subsection (a), the basis for determining the amount of the deduction for any bad debt shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.
. . .
(d) Nonbusiness debts. -
(1) General rule. - In the case of a taxpayer other than a corporation -
(A) subsection (a) shall not apply to any nonbusiness debt; and
(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 1 year.
(2) Nonbusiness debt defined. - For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than -
(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or
(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

(e) Worthless securities. - This section shall not apply to a debt which is evidenced by a security as defined in section 165(g)(2)(C).

(f) Cross references. -
(1) For disallowance of deduction for worthlessness of debts owed by political parties and similar organizations, see section 271.
(2) For special rule for banks with respect to worthless securities, see section 582.

In 2014, the Indiana Tax Court further addressed Indiana's bad debt statute in *SAC Finance, Inc. v. Indiana Dept. of State Revenue*, and explained in part:

Having decided that SAC's use of the Market Discount Rules to calculate its federal bad debt deduction under IRC § 166 was proper, the Court turns to whether the Indiana Bad Debt Statute excludes SAC's market discount income from the Indiana bad debt calculation. The Indiana Bad Debt Statute, in relevant part, states:

(a) In determining the amount of [sales] and use taxes to which a retail merchant must remit under [Indiana Code § 6-2.5-6-7], the retail merchant shall, subject to subsections (c)8 and (d), deduct from the retail merchant's gross income from retail transactions made during a particular reporting period, an amount equal to the retail merchant's receivables which ... were written off as uncollectible debt for federal tax purposes under [IRC § 166] during the particular reporting period.

. . . .

(d) The following provisions apply to a deduction for a receivable treated as uncollectible debt under subsection (a):
(1) The deduction does not include interest.
(2) The amount of the deduction shall be determined in the manner provided by [IRC § 166] for bad debts but shall be adjusted to exclude:
(A) financing charges or interest;
(B) sales or use taxes charged on the purchase price;
(C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;
(D) expenses incurred in attempting to collect any debt; and
(E) repossessed property.

I.C. § 6-2.5-6-9(a)(3), (d)(1)-(2) (footnote added).

The Indiana Bad Debt Statute first requires a retail merchant (or its assignee) to deduct the amount written off as uncollectible debt for federal tax purposes under IRC § 166 from its gross retail income. *See* I.C. § 6-2.5-6-9(a)(3). Accordingly, the amount written off under IRC § 166 is incorporated into the Indiana calculation solely as the computational starting point in determining Indiana's bad debt deduction.

Indiana Code § 6-2.5-6-9(d) (hereinafter "Subsection (d)") lists the types of revenue that must be excluded from this starting point in calculating the amount of the Indiana bad debt deduction. I.C. § 6-2.5-6-9(d)(1)-(2). Specifically, Subsection (d) requires a taxpayer to exclude amounts that reduce the original sales tax base (*i.e.*, the value of repossessed property or property still in the seller's possession) and that were not part of the original retail sales tax base (i.e., interest, financing charges, sales or use tax, and debt collection expenses) from the difference between gross retail income and the amount of the federal bad debt. . . . .

SAC Finance, Inc. v. Indiana Dept. of State Revenue, 24 N.E.3d 541, 545-46 (Ind. Tax Ct. 2014) (**Emphasis added**).

Accordingly, when a car dealership collects the sales tax (on sales of cars) under installment contracts and subsequently assigned to a related entity, such as Taxpayer in this instance, which eventually claims the refund of the sales tax pursuant to Indiana law, the entity claiming the refund is required to substantiate its refund claim pursuant to the above-mentioned statutes.

Throughout the protest, in addition to copies of partial "Vehicle Order Agreement[s]" and valuation of vehicles, Taxpayer provided an unsigned copy of its first page of 1120S Form for the 2014 year, summaries or excerpts of its general ledger, and a limited number of samples of the transactions to support its protest.

Upon review, however, Taxpayer's reliance on its supporting documentation is mistaken. Specifically, in this instance, the Department requested the following:

1. Who is (are) the related retailer(s) to [Taxpayer]?
2. Who are the shareholders and ownership percentages of the retailer(s) and [Taxpayer]?
3. Please provide an Excel worksheet of the refund claim and the following for each transaction?

- Bill of sale
- Finance contract
- Account detail for each customer
- Receipt, check copy, etc. for the disposal of repossessed vehicle OR what valuation was used for those put back in inventory.

Taxpayer answered some - but not all - of the above questions. Taxpayer also failed to provide the complete information requested by the Department to support its refund claim, including an "Account detail for each customer" and "[r]eceipt, check copy, etc. for the disposal of repossessed vehicle OR what valuation was used for those put back in inventory." Moreover, Taxpayer failed to provide its complete 2014 returns to support its claimed deduction pursuant to I.R.C. § 166. A publicly verifiable record showed that, previously, Taxpayer protested the same issue for the 2012 tax year. In that final determination, Final Order Denying Refund 04-20160448R (August 2017), 20171129 Ind. Reg. 045170534NRA, the Department found:

Taxpayer's federal return did not list any amount on line ten (10) of its 1120S federal income tax return, which is the line for bad debts. Rather, the amount Taxpayer refers to in its claim for refund of sales tax is found on line nineteen (19) of its 1120S, which is the line for other deductions. The amount listed on line nineteen is explained on statement 3 and includes "repossession losses."

For 2014, Taxpayer simply offered the first page of its unsigned 1120S. The Department thus is not able to agree that Taxpayer substantiated what was listed on line ten (10) of its 1120S federal income tax return. Without the verifiable supporting documentation, Taxpayer failed to substantiate that it was entitled to the refund of sales tax under IC § 6-2.5-6-9.

FINDING

Taxpayer's protest of the refund denial is respectfully denied.

November 7, 2018

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An html version of this document.